ORIGINAL

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MEMORANDUM

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TO: Docket Control

FROM: Ernest Johnson
Director
Utilities Division

DATE: September 24, 2007

RE: STAFF REPORT FOR WATCO, INC.'S APPLICATION FOR A PERMANENT RATE INCREASE (DOCKET NO. W-20475A-06-0550) and W-20475A-06-0357

Attached is the Staff Report for Watco, Inc.'s application for a permanent rate increase. Staff recommends approval of its rates and charges.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before October 9, 2007.

EGJ:CSB:tdp

Originator: Crystal S. Brown

Service List for: Watco, Inc.
Docket Nos. W-20475A-06-0550 and W-20475A-06-0357

Mr. Mark Grapp
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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

WATCO, INC.
DOCKET NO. W-20475A-06-0550

APPLICATION
FOR A
PERMANENT RATE INCREASE

SEPTEMBER 24, 2007

STAFF ACKNOWLEDGMENT

The Staff Report for Watco, Inc. ("Company"), Docket Nos. W-20475A-06-0550 and W-20475A-06-0357, was the responsibility of the Staff members listed below. Crystal Brown was responsible for the review and analysis of the Company's application for a permanent rate increase, Staff's revenue requirement, rate base, and rate design. Katrin Stukov was responsible for the engineering and technical analysis. Deborah Reagan was responsible for reviewing the Arizona Corporation Commission's ("Commission") records on the Company and reviewing customer complaints filed with the Commission.

Crystal S. Brown
Public Utilities Analyst V

Katrin Stukov
Utilities Engineer

Katrin Stukov

Deborah Reagan

Deborah Reagan
Public Utilities Consumer Analyst II

EXECUTIVE SUMMARY OF
WATCO, INC.'S
APPLICATION FOR A PERMANENT RATE INCREASE
DOCKET NOS. W-20475A-06-0550 AND W-20475A-06-0357

Watco, Inc. ("Watco" or "Company") serves approximately 289 customers and is located north of Show Low in Navajo County, Arizona.

The Company proposes total operating revenue of $173,572[1], an increase of $81,735, or 89.00 percent above the Company's test year revenue of $91,837. Staff recommends total operating revenue of $141,873, an increase of $50,036, or 54.48 percent above the test year revenue of $91,837. The Company has requested and Staff has recommended approval of a $600,000 loan (Docket No. W-20475A-06-0357 which has been consolidated with the instant case). Staff's recommended increase provides sufficient cash flow to pay cash operating expenses, contingencies, principal, interest, and meets the minimum 1.2 debt service coverage ratio required for the loan.

The Company's proposed rates would increase the typical residential bill with a median usage of 3,317 gallons, from $22.01 to $39.93 for an increase of $17.92 or 81.4 percent. Staff's recommended rates would increase the typical residential bill with a median usage of 3,317 gallons, from $22.01 to $32.27 for an increase of $10.26 or 46.6 percent.

Staff Recommendations

Staff recommends approval of the Staff proposed rates and charges as shown in Schedule CSB-4. Staff further recommends that the Company be ordered to file with Docket Control a tariff schedule of its new rates and charges within 30 days after the effective date of the Decision in this proceeding.

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[1] The Company's proposed rates would actually generate total annual revenue of $163,463, $10,109 less than the $173,572 requested on page 6 of the application.

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SCHEDULES

ATTACHMENT

Fact Sheet

Company:

Current Rates: Decision No. 66175, dated August 15, 2003
Type of Ownership: S Corporation

Location: The Company is located north of the community of Show Low, in Navajo County, Arizona. The Company is not located in an Active Management Area ("AMA").

Rates:

Permanent rate increase application filed: August 31, 2006
Current test year Ended: December 31, 2005
Prior test year Ended: December 31, 2001

Monthly Charges:

	Current Rates	Company Proposed Rates	Staff Recommended Rates
Monthly Minimum Charge			
5/8 x 3/4 – inch meter	$14.55	$27.50	$22.00
Gallons in Minimum	0	0	0
Commodity Charge			
0 to 3,000 gallons (per 1,000 gallons)	$ N/A	$ N/A	$ 3.00
3,001 to 10,000 gallons (per 1,000 gallons)	$ N/A	$ N/A	$ 4.00
10,001 to and over gallons (per 1,000 gallons)	$ N/A	$ N/A	$ 5.00
0 to 4,000 gallons (per 1,000 gallons)	$ 2.25	$ 3.75	$ N/A
4,001 to 20,000 gallons (per 1,000 gallons)	$ 2.50	$ 4.00	$ N/A
20,001 and over gallons (per 1,000 gallons)	$ 3.00	$ 4.50	$ N/A

Typical residential bill:

Average use (4,938 gallons)	$25.90	$46.26	$38.75
Median use (3,317 gallons)	$22.01	$39.93	$32.27

Customers:
Number of customers in prior test year (12/31/01) 257

Average Number of customers in the current test year (12/31/05): 289

Current test year customers by meter size:

5/8 X 3/4 – inch	289
3/4 – inch	0
1 – inch	0
1 1/2 – inch	0
2 – inch	0
4 – inch	0
6 – inch	0

Seasonal customers: N/A

Customer notification for rate application filed: July 13, 2007

Number of customer complaints and/or opinions concerning rate application filed: 2

Percentage of complaints to customer base: 0.692% (2 / 289)

Summary of Filing

The test year results as adjusted by Utilities Division Staff ("Staff"), for Watco, Inc. ("Watco" or "Company") show total operating revenue of $91,837 and an operating income of $2,383 or a 2.59 percent operating margin as shown on Schedule CSB-1. The Original Cost Rate Base ("OCRB") as adjusted by Staff is $136,280.

Watco's proposed rates, as requested, would produce total operating revenue of $173,572[2] and operating income of $61,709, or a 35.55 percent operating margin. The Company proposed OCRB is $130,797. The Company's proposed rates would increase the typical residential bill,[3] with a median usage of 3,317 gallons, from $22.01 to $39.94 for an increase of $17.93, or 81.5 percent, as shown on Schedule CSB-5.

Staff recommends rates that would produce total operating revenue of $141,873 and operating income of $52,163, or a 36.77 percent operating margin. Staff recommends an OCRB of $136,280. Staff's recommended rates would increase the typical residential bill with a median usage of 3,317 gallons, from $22.01 to $32.27 for an increase of $10.26 or 46.6 percent, as shown on Schedule CSB-5.

Background

On September 7, 1965, the Arizona Corporation Commission ("Commission") in Decision No. 38013, granted Silverwell Service Corporation a certificate of convenience and

[2] The Company requested total operating revenue of $173,572 on page 6 of the application. However, the proposed metered rates ($162,363) and other water revenue ($1,100) produced revenue of only $163,463.
[3] 5/8 x 3/4 –inch meter

necessity ("CC&N") to operate a domestic water utility. The Company later began experiencing numerous service problems and customer complaints. Resolution of these problems and Commission concerns led to the Company filing a rate application and attending a hearing in 1989.[4] Ongoing problems caused Silverwell's corporate status to be revoked by the Commission on November 10, 1991.

In 1992, Mr. Mark Grapp began managing and operating the problematic Company with the intent of purchasing the water system. In 1996, Mr. Grapp purchased the assets of Silverwell Service Corporation and began conducting business under the name of Watco, Inc. ("Watco"). The owners of Silverwell did not obtain Commission approval prior to initiating the sale of assets.

On August 31, 2006, Mr. Grapp, under the name of Watco, filed an application for a permanent rate increase.

<u>Transfer of CC&N from Silverwell to Watco</u>

Also, on August 31, 2006, Watco filed an application for approval of the sale of Silverwell's assets and transfer of Silverwell's CC&N to Watco, Inc. The Utilities Division Staff informed Mr. Grapp that Watco needed to obtain Commission approval for the sale of assets and transfer of CC&N before Staff could find the rate application sufficient.

On November 13, 2006, the Company requested consolidation of the rate, financing and sale of assets applications. On November 30, 2006, by Procedural Order, the Company's rate case and financing applications were consolidated. The sale of assets and transfer of CC&N application was processed separately. On March 26, 2007, the Commission approved the sale of assets and transfer of CC&N to Mr. Grapp in Decision No. 69391. On April 11, 2007, Staff filed a letter of sufficiency for the rate application.

<u>Financing</u>

On May 30, 2006, Mr. Grapp filed a financing application requesting authority to borrow $600,000 (Docket No. W-20475A-06-0357). On November 30, 2006, by Procedural Order, the Company's rate case and financing applications were consolidated. Pedro Chaves is the Staff analyst responsible for the financial examination and recommendations for that application. A complete discussion of Staff's analysis on the financing application is filed concurrently but separately in Docket No. W-20475A-06-0357.

<u>Test Year Customers</u>

During the test year ended December 31, 2005, Watco provided water service to an average of 289 metered customers. All customers are served by 5/8 x 3/4 -inch meters.

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[4] Decision No. 57034, dated July 19, 1990

Consumer Services

Staff reviewed the Commission's records and found no complaints, four inquiries, and two opinions (both were opposed to the rate increase) for the period January 2005 to June 29, 2007. For the year 2004, Staff's review found no complaints, one inquiry, and six opinions. All opinions were against a proposed rate increase that the Company later withdrew.

Engineering Analysis and Recommendations

Staff inspected the Company's plant facilities on December 7, 2006. A complete discussion of Staff's technical findings and recommendations and a complete description of the water system are provided in the attached Engineering Report.

Compliance

Watco is current on its Utilities and Corporations annual reports. Watco is also current on its sales and property tax payments.

The U.S. Environmental Protection Agency announced that the arsenic standard in drinking water will be reduced from 50 parts per billion (ppb) to 10 ppb by 2006. The Company is currently in compliance with the new arsenic maximum contaminant level.

Rate Base

Staff's adjustments increased the Company's proposed rate base by $5,483, from $130,797 to $136,280 as shown on Schedule CSB-2, page 1. Details of Staff's adjustments are discussed below.

Plant in Service

Staff's adjustments to plant in service resulted in a net decrease of $12,022 as shown on Schedule CSB-2, page 2.

Structures and Improvements - Adjustment "a" decreases this account by $4,000, from $9,135 to $5,135 as shown on Schedule CSB-2, pages 2 and 3. Staff's adjusted amount reflects a $4,000 retirement not reported in the original application.

Pumping Equipment - Adjustment "b" decreases this account by $400, from $13,023 to $12,623 as shown on Schedule CSB-2, pages 2 and 3. Staff's adjusted amount reflects the removal of costs the Company erroneously reported and later corrected through response to a data request.

Distribution Reservoirs, Storage - Adjustment "c" increases this account by $18,265, from $0 to $18,265 as shown on Schedule CSB-2, pages 2 and 3. The Company reported

$59,016 for its distribution reservoirs total balance. The account was composed of costs incurred for both storage and pressure tanks. The current depreciation rate is 2.22 percent for storage tanks and 5.00 percent for pressure tanks. Staff noted that the Company had inappropriately applied a 5.00 percent depreciation rate to the entire balance of the distribution reservoirs account balance. Staff's adjusted amount segregates the storage tank costs from the pressure tank costs in order to apply the appropriate current depreciation rate.

Distribution Reservoirs, Pressure - Adjustment "d" decreases this account by $33,938, from $59,016 to $25,078 as shown on Schedule CSB-2, pages 2 and 3. Staff's adjusted amount reflects Company provided corrections verified by Staff and the reclassification of $18,265 in storage tank costs to the "Distribution Reservoirs, Storage" account as discussed in Adjustment c above.

Transmission and Distribution Mains - Adjustment "e" increases this account by $9,156, from $371,788 to $380,944 as shown on Schedule CSB-2, pages 2 and 3. Staff's adjusted amount reflects the Company provided corrections verified by Staff.

Meters and Meter Installations - Adjustment "f" decreases this account by $1,105, from $24,144 to $23,039 as shown on Schedule CSB-2, pages 2 and 4. Staff's adjusted amount reflects the Company provided corrections verified by Staff.

Accumulated Depreciation

Staff decreased accumulated depreciation by $9,346 from $433,029 to $423,683 as shown on Schedule CSB-2, page 5. The decrease is based upon the adjustments Staff made to plant in service.

Working Capital

Staff's adjustments to working capital resulted in a net increase of $8,159, from $0 to $8,159 as shown on Schedule CSB-2, pages 1 and 5 primarily as a result of increasing cash working capital.

Cash working capital was calculated by using the formula method which equals one-eighth of the operating expenses less depreciation, taxes, purchased power and purchased water expenses, plus one twenty-fourth of purchased power and purchased water expenses.

Affiliated Companies and Allocations

Watco is one of five companies[5] operated from an office located at 340 N. 9th Street in Show Low, Arizona. All five companies are owned by Mr. Grapp and are Commission regulated with the exception of Cedar Grove Water Management Company.

The owner uses shared services to manage and operate the five companies. Shared service expenses accounted for approximately 70 percent of Watco's test year expenses. The shared services include, but are not limited to, employees, transportation, office building space, office supplies, utilities, computers, computer software, telephone, insurance, and other miscellaneous services. Also, Mr. Grapp's officer's salary is allocated among the four regulated companies.

Additionally, Mr. Grapp owns a payroll company (Four Star Land Development) that processes payroll for the four regulated companies. Four Star Land Development is not located at the same office as the other five companies. The Company states that no affiliate profit is included in the billings of any affiliate company.

The primary goal of cost allocation is to prevent or limit, as much as possible, any cross-subsidization of customers from one company by customers of another company. Staff reviewed the allocation methodology used by Watco. Staff found that Watco allocates some expenses based on a single factor (i.e., the number of customers per regulated utility) and allocates other expenses on a 50/50 split between Watco and Cedar Grove.

The single factor allocation methodology that Watco uses is inappropriate because it always results in the utility company with the largest number of customers (i.e., Watco) paying the largest amount of the allocated cost regardless of any direct causal relationship between the number of customers and that cost.

For example, the owner's officer's salary of $66,776 is allocated among the four regulated utilities based on the number of customers per utility. The owner could, in any given year, spend significantly more time on one of his three smaller utilities (e.g., Serviceberry which has 22 customers) due to complex and/or high numbers of problems arising in it as compared to Watco (which has 289 customers). If this occurs, the cost causation ratemaking principle indicates that Serviceberry would be allocated most of the owner's officer's salary. However, under the Company's present methodology, Watco would be unfairly allocated most of the officer's salary.

The Company also allocates office rent expense solely on customer count. Office rent is impacted more by the total number of office employees and their direct labor hours than by customer count.

[5] Watco, Inc.; Cedar Grove Water Company, Inc.; Cedar Grove Water Management Company; A Peterson Water Company; and Serviceberry Water Company, Inc.

Staff noted that the insurance expense covering all five companies' property was allocated equally between Watco and Cedar Grove. No allocations were made to any of the other companies. Property insurance is more related to net plant than customer count. Further, the 50/50 split between Watco and Cedar Grove results in the customers of Watco and Cedar Grove subsidizing the customers of Serviceberry, A. Peterson, and the unregulated company.

Staff also noted that the Company allocated transportation expense and office supplies expense (which included water, gas, electric, telephone, cell phone, pager, computer software, business forms, etc.) on a 50/50 split between Watco and Cedar Grove. No allocations were made to the two smaller utilities (i.e., Serviceberry and A. Peterson). This also results in the customers of Watco and Cedar Grove subsidizing the customers of Serviceberry and A. Peterson.

One of the principles contained in the National Association of Regulatory Commissioners ("NARUC") Guideline for Cost Allocations and Affiliate Transactions states that:

> The primary cost driver of common costs, or a relevant proxy in the absence of a primary cost driver, should be identified and used to allocate the cost between regulated and non-regulated services or products. (Emphasis added).

Further, the NARUC Guideline for Cost Allocations and Affiliate Transactions states that:

> To the maximum extent practicable, in consideration of administrative costs, costs should be collected and classified on a direct basis for each asset, service or product provided. (Emphasis added).

Moreover, the NARUC Guideline for Cost Allocations and Affiliate Transactions states that:

> The indirect costs of each business unit, including the allocated costs of shared services, should be spread to the services or products to which they relate using relevant cost allocators. (Emphasis added).

Staff utilized the NARUC Cost Allocation guidelines to identify four relevant cost drivers of the Company's indirect shared expenses. The equally weighted factors used in calculating the general allocation percentage are as follows:

1. Direct labor hours of employees
2. Direct operating expense
3. Number of customers, and
4. Net plant

Staff's calculation of the four-factor general allocation percentage is shown on CSB-3, Page 9. Staff recommends that Watco adopt Staff's four-factor allocation methodology. Staff's methodology produces a more equitable allocation of shared indirect expenses because it more closely follows the NARUC Cost Allocation guidelines of identifying relevant cost drivers and utilizing direct costs to the extent possible.

Operating Income Statement

Operating Revenue

Staff concurs with the Company's test year operating revenue as shown on Schedule CSB-3, page 1.

Operating Expenses

Staff's adjustments to operating expenses resulted in a net decrease of $22,152 as shown on Schedule CSB-3, page 1. Details of Staff's adjustments are discussed below.

Staff's adjustments relate primarily to the allocation of shared expenses using Staff's four-factor allocation percentage. For shared expenses that Staff determined were incurred only for the four regulated companies, Staff allocated the entire expense to the four regulated companies. For shared expenses that also benefited the unregulated company, Staff removed the portion of expense attributed to the unregulated company and allocated the remaining balance of the expense among the four regulated companies.

Salaries and Wages - Adjustment A decreases this account by $8,901, from $51,881 to $42,980 as shown on Schedule CSB-3, pages 1 and 2. The Company's salary and wage expense is composed of $17,295 in shared service employee labor hours directly assigned to Watco and $34,586[6] for Watco's allocated portion of Mr. Grapp's $66,776 officer's salary.

Mr. Grapp does not keep track of the amount of time he spends working directly for each of his various companies. He allocates his officer salary based on the customer count per utility. The Company could not provide any studies to support its single-factor allocation methodology. Staff's adjustment reflects the use of Staff's four-factor allocation percentage to allocate the officer's salary. The Company indicated that the $66,776 salary pertained only to the four regulated companies (CSB 3-12 c).

Office Supplies and Expenses - Adjustment B decreases this account by $1,269, from $6,769 to $5,500 as shown on Schedule CSB-3, pages 1 and 3. The Company's office supplies and expense is composed of $3,054 in costs directly assignable to Watco and $3,715 ($6,769-$3,054) for Watco's allocated portion of shared office expenses (such as office utilities, computer software, business forms, telephones, etc). Staff's adjustment reflects the use of Staff's four-factor allocation percentage to allocate shared office supplies and expenses.

[6] From Company's response to deficiency letter dated October 10, 2006.

The unregulated company benefits from use of the electric, gas, water, phones, computer, etc. However, Staff notes that a full twelve months of costs for electric, gas, water, and phone bills were not included in the office supplies and expenses. Therefore, Staff allocated the entire office supplies and expenses to only the four regulated companies as Staff attributed the omitted costs to the unregulated company.

Outside Services - Adjustment C decreases this account by $1,368, from $2,694 to $1,326 as shown on Schedule CSB-3, pages 1 and 4. Staff removed costs incurred for preparation of the owner's personal income taxes; costs that were incurred outside the test year; and engineering costs relating to the installation of a tank that were inappropriately expensed. Staff's adjustment reflects Staff's adjusted balance allocated using Staff's four-factor allocation percentage. Staff reviewed the expenses and determined that the unregulated business received minimal, if any, benefits from the outside services.

Water Testing - Adjustment D increases this account by $1,599, from $222 to $1,821 as shown on Schedule CSB-3, pages 1 and 4. This adjustment reflects the normalized annual water testing costs determined by Staff and reported in Table B of the attached Engineering Report. This cost is incurred only for Watco.

Rents Expense - Adjustment E decreases this account by $2,742, from $5,901 to $3,159 as shown on Schedule CSB-3, pages 1 and 5. Mr. Grapp stated in response to data request CSB 2-3 b that the rents expense of $684.31 per month (or $8,211.72 annually) pertains only to the four regulated companies. The Company further indicated that Mr. Grapp owns the office in which the companies are located (CSB 3-1 b). Staff reviewed prices of commercial office space in and around the Show Low area and found the price to be reasonable. Staff's adjustment reflects the use of Staff's four-factor allocation percentage to allocate the $8,211.72 rents expense.

Transportation Expense - Adjustment F decreases this account by $1,921, from $6,457 to $4,536 as shown on Schedule CSB-3, pages 1 and 5. Mr. Grapp owns a vehicle that is used for all of the utility companies. No logs tracking the number of miles traveled for each utility is maintained. Watco is allocated a portion of the total expense.

The Company reported total unallocated transportation expense of $7,200. Staff removed $6,600 in expenses pertaining to loan payments for the vehicle. Staff reviewed the remaining $600 ($7,200 - $6,600) in expenses and determined that the unregulated business received minimal, if any, benefits from the $600. Therefore, Staff allocated the $600 only to the four regulated companies using the four-factor allocation percentage. This resulted in $231 allocated to Watco. In addition to the $231, Staff added a $4,305[7] transportation allowance to reflect

[7] The $4,305 was calculated by multiplying the 2006 Internal Revenue Service standard mileage rate (i.e., 0.445) by the estimated number of miles driven by the Company (i.e., 9,675) from the 2001 rate case. For income tax purposes, no tax deduction is allowed without a mileage log. However, Staff allowed a reasonable amount for the expense because it was needed in the provision of service.

usage of the vehicle for only Watco's operation; for total transportation expense of $4,536 ($231 + $4,305).

General Liability Insurance Expense - Adjustment G decreases this account by $1,603, from $2,825 to $1,222 as shown on Schedule CSB-3, pages 1, and 6. The Company provided a 2006 insurance policy that covered all five of the owner's companies with a $3,970 annual premium. Staff removed one-fifth of the cost (which represents the unregulated company's portion) and allocated the remaining four-fifths among the four regulated utilities based upon Staff's four factor allocation percentage for Watco.

Depreciation Expense - Adjustment H decreases this account by $1,384, from $17,174 to $15,790 as shown on Schedule CSB-3, pages 1, and 7. This adjustment reflects application of Staff's recommended depreciation rates to Staff's recommended plant balances for Watco.

Taxes Other Than Income Expense - Staff's adjustment I decreased this account by $4,564, from $4,564 to $0 as shown on Schedule CSB-3, pages 1, and 8. This adjustment reflects Staff's removal of $4,564 identified as sales tax expense in account number 408.2 of the Company's general ledger. Sales taxes are removed from test year revenues so correspondingly, they must be removed from test year expenses.

Interest Expense on L.T. Debt - Adjustment J increases this account by $37,201, from $157 to $37,358 as shown on Schedule CSB-3, page 1 and 8. This adjustment reflects the interest expense on the $600,000 Company proposed and Staff recommended long-term debt for Watco.

<u>Revenue Requirement</u>

Small water utilities will often have a rate base that is too small to earn a meaningful rate of return. Consequently, the revenues needed in order to make the companies financially viable will result in abnormally high rates of return. Watco is among those water companies whose large debt service requirement and small rate base results in abnormally high rates of return when compared to other, more financially capable, companies.

Staff recommends total operating revenue of $141,873, an increase of $50,036, or 54.48 percent above the Company's test year revenue of $91,837. Staff's recommended revenue provides operating income of $52,163 for an operating margin of 36.77[8] percent and a rate of return on original cost rate base of 38.28 percent as shown on Schedule CSB-1.

The 36.77 percent operating margin is high when the cost of the Company proposed $600,000 WIFA[9] loan is not considered. Staff, however, has recommended approval of the loan. Therefore, Staff's revenue requirement is primarily driven by the revenues needed to pay the

[8] Operating margin is calculated by dividing operating income by total operating revenue.
[9] Water Infrastructure Financing Authority

principal, interest, and to meet the minimum 1.2 debt service coverage ratio ("DSC") required by WIFA on the loan. Additionally, Staff's revenue requirement provides sufficient cash flow to pay cash operating expenses and contingencies as shown on Schedules CSB-1 and CSB-6. A complete discussion of Staff's analysis on the financing application is presented in the consolidated financing Staff Report (Docket No.W-20475A-06-0357).

Rate Design

Schedule CSB-4 presents a complete list of the Company's present, proposed, and Staff's recommended rates and charges.

The Company's present monthly customer charges vary by meter size as follows: 5/8-¾ inch $14.55; ¾-inch, $22.00; 1-inch, $40.00; 1½-inch, $74.00; 2-inch, $118.00; 3-inch, $221; 4-inch, $369; and 6-inch, $738. No gallons are included in the minimum. The present commodity rate[10] is $2.25 for 0 to 4,000 gallons; $2.50 for 4,001 to 20,000 gallons; and, $3.00 for over 20,000.

The median usage is 3,317 gallons. Staff recommends lowering the first and second tier break-over points to 3,000 and 10,000 gallons, respectively, to further encourage conservation.

Under current rates, approximately 55.1 percent of the Company's revenue is generated from the monthly customer charge and 48.9 percent is generated from the commodity charge. Staff's recommended rate design preserves revenue stability by making no significant decrease in the percentage of revenue generated by the minimum charge. Likewise, it maintains customers' ability to control the amount of their bills by making no significant decrease in the percentage of revenue generated by the commodity charge.

The Company proposed to add a bulk water rate of $6.50 per 1,000 gallons. Staff recommends a $5.00 rate which is consistent with Staff's third tier range.

Miscellaneous Service Charges

The Company has proposed increases to its meter test (if correct), deposit, NSF, meter re-read, and late fees. Staff notes that any increase in miscellaneous service charges recommended by Staff will have no effect on Staff's total annual operating revenue. This is because Staff offsets any increase in miscellaneous service charges with an equal decrease in metered revenue.

Staff reviewed the miscellaneous service charges in question and found that the current rates are within the range of service charges typically approved by the Commission. The Company explained that the increases were needed due to higher labor and transportation costs. This explanation, without a supporting cost analysis, is not sufficient evidence to increase the charges because it does not provide the detail to determine the amount, if any, the charges should

[10] Rate is per 1,000 gallons.

be increased. Further, all increased labor and transportation costs are reflected in Staff's recommended operating expenses, which in turn, are reflected in Staff's recommended metered water revenues. Therefore, Staff recommends no increases for these charges.

The Company has proposed to add to its current tariff a "Reconnection (Delinquent – After Hours)" charge of $60. Staff recommends a $37.50 fee calculated by multiplying the current "Reconnection (Delinquent)" charge of $25 by 1.5 to reflect the time and a half labor rate.

Service Line and Meter Installation Charges

Staff recommends approval of Staff's Service Line and Meter Installation Charges as shown on Table C of the attached Engineering Report.

Staff Recommendations

Staff recommends approval of the Staff proposed rates and charges as shown in Schedule CSB-4. Staff further recommends that the Company be ordered to file with Docket Control a tariff schedule of its new rates and charges within 30 days after the effective date of the Decision in this proceeding.

Staff further recommends that Watco be ordered to adopt Staff's four-factor allocation methodology.

Staff further recommends that the Company be ordered to file with Docket Control, as a compliance item in this docket, a tariff schedule of its new rates and charges within 30 days after the effective date of the Decision in this proceeding.

The Silver Lake water system has water loss of 14.5%. Staff recommends that the Company continue to monitor its system and, in compliance with Decision No. 66175 dated August 13, 2003, annually report to the ACC the number of meters replaced and the water loss data including quantity of water pumped, gallons sold and water loss percentage for each month. The Company shall file its first report with Docket Control, as a compliance item in this docket, within six month of the effective date of the decision in this case. The Company shall reduce its water loss to 10% or less by December 31, 2009.

Staff recommends that any decision granting the new rates and charges in this proceeding should not become effective until the Company file with Docket Control, as a compliance item in this docket, a copy of the ADEQ Approval to Construct ("ATC") or a letter that an ATC is not required from ADEQ for the interconnection of the Silver Lake and Bourdon Ranch systems, as ordered in Decision No. 69391 dated March 22, 2007.

Staff recommends that in compliance with Decision No. 69391 dated March 22, 2007, the Company file, by June 1, 2008, with Docket Control, as a compliance item in this docket, a copy of the ADEQ Approval of Construction ("AOC") for the interconnection of the Silver Lake and Bourdon Ranch systems.

Staff recommends that the Company continue using depreciation rates by individual NARUC category as delineated in Exhibit 3.

The Company has proposed to reduce its 5/8 X 3/4 meter and service line installation charge to $0.00. All other charges would remain the same. Staff separated service line and meter installation charges and recommends that charges listed in the right-hand column in Table "C" be adopted (See Section K – Service Line and Meter Installation Charges for further discussion).

Staff recommends that the Commission approval of the Financing Application for Phase 1 improvements be conditional on the Company filing with Docket Control, as a compliance item in this docket, a copy of the ADEQ ATC for the proposed storage tank by June 1, 2008.

Watco, Inc.
Docket No. W-20475A-06-0550 — Schedule CSB-1
Test Year Ended December 31, 2005

SUMMARY OF FILING

	-- Present Rates --		-- Proposed Rates --	
	Company as Filed	Staff as Adjusted	Company as Filed	Staff as Adjusted
Revenues:				
Metered Water Revenue	$90,737	$90,737	$172,472	$140,773
Unmetered Water Revenue	0	0	0	0
Other Water Revenues	1,100	1,100	1,100	1,100
Total Operating Revenue	$91,837	**$91,837**	$173,572	**$141,873**
Operating Expenses:				
Operation and Maintenance	$86,900	$70,673	$86,900	$70,695
Depreciation	17,174	15,790	17,174	15,790
Property & Other Taxes	7,789	3,225	7,789	3,225
Income Tax	0	0	0	0
Total Operating Expense	$111,863	**$89,689**	$111,863	**$89,711**
Operating Income/(Loss)	($20,026)	**$2,148**	$61,709	**$52,163**
Rate Base O.C.L.D.	$130,797	$136,280	$130,797	$136,280
Rate of Return - O.C.L.D.	N/M	1.58%	47.18%	38.28%
Times Interest Earned Ratio (Pre-Tax)	N/M	N/M	1.65	1.40
Debt Service Coverage Ratio (Pre-Tax)	N/M	N/M	1.49	1.29
Operating Margin	-21.81%	2.34%	35.55%	36.77%

NOTES:
1. The times interest earned ratio (TIER) represents the ability of the Company to pay interest expenses before taxes.
2. Operating Margin represents the proportion of funds available to pay interest and other below the line or non-ratemaking expenses.

N/M: Not Meaningful

Watco, Inc.
Docket No. W-20475A-06-0550
Test Year Ended December 31, 2005

RATE BASE

	Original Cost						
		Company		Adjustment	Ref		Staff
Plant in Service	$	591,158	$	(12,022)	A	$	579,136
Less:							
Accum. Depreciation		433,029		(9,346)	B		423,683
Net Plant	$	158,129	$	(2,676)		**$**	**155,453**
Less:							
Line Extension Advances	$	-	$	-		$	-
Service Line and Meter Advances		27,332		-			27,332
Total Advances	$	27,332	$	-		$	27,332
Contributions Gross	$	-	$	-		$	-
Less:							
Amortization of CIAC		-		-			-
Net CIAC	$	-	$	-		$	-
Total Deductions	$	27,332	$	-		**$**	**27,332**
Plus:							
1/24 Purchased Power & Water	$	-	$	339	C	$	339
1/8 Operation & Maint.		-		7,819	D		7,819
Inventory		-		-			-
Prepayments		-		-			-
Total Additions	$	-	$	8,159		**$**	**8,159**
Rate Base	**$**	**130,797**	**$**	**5,483**		**$**	**136,280**

Explantion of Adjustments
- A - See Schedule 2, Page 2
- B - See Schedule 2, Page 4
- C - See Schedule 2, Page 5
- D - See Schedule 2, Page 5

Watco, Inc.
Docket No. W-20475A-06-0550
Test Year Ended December 31, 2005

PLANT ADJUSTMENT

	Company Exhibit	Adjustment		Staff Adjusted
301 Organization	$1,542	$0		$1,542
302 Franchises	7	0		$7
303 Land & Land Rights	27,094	0		$27,094
304 Structures & Improvements	9,135	(4,000)	a	$5,135
307 Wells & Springs	19,361	0		$19,361
311 Pumping Equipment	13,023	(400)	b	$12,623
320 Water Treatment Equipment	0	0		$0
330.1 Distribution Reservoirs - Storage	0	18,265	c	$18,265
330.1 Distribution Reservoirs - Pressure	59,016	(33,938)	d	$25,078
331 Transmission & Distribution Mains	371,788	9,156	e	$380,944
333 Services	66,048	0		$66,048
334 Meters & Meter Installations	24,144	(1,105)	f	$23,039
335 Hydrants	0	0		$0
336 Backflow Prevention Devices	0	0		$0
339 Other Plant and Misc. Equipment	0	0		$0
340 Office Furniture & Equipment	0	0		$0
341 Transportation Equipment	0	0		$0
343 Tools Shop & Garage Equipment	0	0		$0
344 Laboratory Equipment	0	0		$0
345 Power Operated Equipment	0	0		$0
346 Communication Equipment	0	0		$0
347 Miscellaneous Equipment	0	0		$0
348 Other Tangible Plant	0	0		$0
105 C.W.I.P.	0	0		$0
TOTALS	$591,158	($12,022)		**$579,136**

For Explanations of Adjustments, see Schedule 2, Page 3.

Watco, Inc.
Docket No.: W-20475A-06-0550
Test Year Ended: December 31, 2005

STAFF PLANT ADJUSTMENTS

a - STRUCTURES & IMPROVEMENTS - Per Company	$9,135		
Per Staff	5,135	($4,000)	

To reflect plant retirement not reported in original application.

b - PUMPING EQUIPMENT - Per Company	$13,023	
Per Staff	12,623	($400)

To remove costs that the Company erroneously reported and later corrected through response to a data request.

c - DISTRIBUTION RESERVIORS, STORAGE - Per Company	$0	
Per Staff	18,265	$18,265

To separate storage tank costs from pressure tank costs in order to apply the correct depreciation rate (i.e. 2.22%) to the correct balance.

$	-	Ending balance in last rate case
$	16,065	Storage tank addition
$	2,200	Engineering costs inappropriately expensed
$	18,265	Staff Account Balance

d - DISTRIBUTION RESERVIORS, PRESSURE - Per Company	$59,016	
Per Staff	25,078	($33,938)

To separate storage tank costs from pressure tank costs in order to apply the correct depreciation rate (i.e. 5.0%) to the correct balance.

$	34,234	Ending balance in last rate case
$	(9,156)	Pressure tank retirement
$	-	Reclassified to Acct. No. 330.2, Pressure Tanks
$	25,078	Staff Account Balance

$	59,016	Company balance
$	(25,078)	Less: Staff balance
$	33,938	Staff adjustment

e - TRANSMISSION AND DISTRIBUTION MAINS - Per Company	$371,788	
Per Staff	380,944	$9,156

To properly reflect account using information Company provided in response to a data request as follows:

$	380,775	Ending balance in last rate case
$	1,212	Main addition
$	(1,043)	Main retirement
$	380,944	Staff Account Balance

$	380,944	Staff balance
$	(371,788)	Less: Company balance
$	9,156	Staff adjustment

Watco, Inc.
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Test Year Ended: 31-Dec-05

STAFF PLANT ADJUSTMENTS

f	- METERS AND METER INSTALLATIONS - Per Company	$24,144	
	Per Staff	23,039	($1,105)

To properly reflect account using information Company provided in response to a data request as follows:

$	14,094	Ending balance in last rate case
$	3,850	2002 addition
$	2,494	2003 addition
$	3,706	2005 addition
$	(1,105)	2005 retirement
$	23,039	Staff Account Balance
$	24,144	Company balance
$	(23,039)	Less: Staff balance
$	1,105	Staff adjustment

Watco, Inc.
Docket No. W-20475A-06-0550 Schedule CSB-2
Test Year Ended December 31, 2005

ACCUMULATED DEPRECIATION ADJUSTMENT

		Amount
Accumulated Depreciation - Per Company	$	433,029
Accumulated Depreciation - Per Staff		423,683
Total Adjustment	**$**	**(9,346)** B

To reflect Staff's calculation of accumulated depreciation expense based upon Staff's adjustments to plant.

STAFF RATE BASE ADJUSTMENTS

F -	WORKING CAPITAL (1/24 PURCHASED PWR & WTR) - Per Company	$	-	
	Per Staff		339	$339

To reflect Staff's calculation of working capital based upon
Staff's recommendations for purchased power and purchased water.

G -	WORKING CAPITAL (1/8 OPERATION & MAINT EXP) - Per Company	$	-	
	Per Staff		7,819	$7,819

To reflect Staff's calculation of working capital based upon
Staff's recommendations for operation and maintenance expense
(excluding purchased power and purchased water expenses).

Watco, Inc.
Docket No. W-20475A-06-0550
Test Year Ended December 31, 2005

STATEMENT OF OPERATING INCOME

	Company Exhibit	Staff Adjustments		Staff Adjusted
Revenues:				
461 Metered Water Revenue	$ 90,737	$ -		$ 90,737
460 Unmetered Water Revenue	$ -	$ -		$ -
474 Other Water Revenues	$ 1,100	$ -		$ 1,100
Total Operating Revenue	$ 91,837	$ -		**$ 91,837**
Operating Expenses:				
601 Salaries and Wages	$ 51,881	$ (8,901)	A	$ 42,980
610 Purchased Water	$ -	$ -		$ -
615 Purchased Power	$ 8,140	$ -		$ 8,140
618 Chemicals	$ -	$ -		$ -
620 Repairs and Maintenance	$ 2,011	$ -		$ 2,011
621 Office Supplies & Expense	$ 6,769	$ (1,269)	B	$ 5,500
630 Outside Services	$ 2,694	$ (1,368)	C	$ 1,326
635 Water Testing	$ 222	$ 1,599	D	$ 1,821
641 Rents	$ 5,901	$ (2,742)	E	$ 3,159
650 Transportation Expenses	$ 6,457	$ (1,921)	F	$ 4,536
657 Insurance - General Liability	$ 2,825	$ (1,603)	G	$ 1,222
659 Insurance - Health and Life	$ -	$ -		$ -
666 Regulatory Commisssion Expense - Rate Case	$ -	$ -		$ -
675 Miscellaneous Expense	$ -	$ -		$ -
403 Depreciation Expense	$ 17,174	$ (1,384)	H	$ 15,790
408 Taxes Other Than Income	$ 4,564	$ (4,564)	I	$ -
408.11 Property Taxes	$ 3,225	$ -		$ 3,225
409 Income Tax	$ -	$ -		$ -
Total Operating Expenses	$ 111,863	$ (22,152)		**$ 89,711**
OPERATING INCOME/(LOSS)	**$ (20,026)**	**$ 22,152**		**$ 2,126**
Other Income/(Expense):				
419 Interest and Dividend Income	$ -	$ -		$ -
421 Non-Utility Income	$ -	$ -		$ -
427 Interest Expense	$ 157	$ 37,201	J	$ 37,358
426 Miscellaneous Non-Utility Expense	$ -	$ -		$ -
	$ -	$ -		$ -
Total Other Income/(Expense)	$ (157)	$ (37,201)		$ (37,358)
NET INCOME/(LOSS)	**$ (20,183)**	**$ (15,049)**		**$ (35,232)**

Watco, Inc.
Docket No. W-20475A-06-0550
Test Year Ended December 31, 2005

STAFF ADJUSTMENTS

A - SALARIES AND WAGES - Per Company $ 51,881
Per Staff 42,980 ($8,901)

To reflect Staff's calculation of the allocated portion of the officer's salary using Staff's four-factor allocation methodology.

	Salaries and Wage Expense		
	Per Response to Deficiency Letter dated 10-10-06		
	Total Per Company	Staff Adjustment	Total Per Staff
Mark Grapp, President & Manager	$ 34,586.53	**$ (8,900.51)**	**$ 25,686.02**
Thomas Grapp, Assist. Manager	$ 682.57	$ -	$ 682.57
Lori Baker, Office Assistant	$ 485.80	$ -	$ 485.80
Ty Harmon, Serviceman	$ 1,023.55	$ -	$ 1,023.55
Barbie Grapp, PT Office Assistant	$ 451.18	$ -	$ 451.18
Mark Grapp, II, Serviceman	$ 453.60	$ -	$ 453.60
Robert Laughlin, Serviceman	$ 72.80	$ -	$ 72.80
Lyndee Grapp, PT Office Assistant	$ 4,603.51	$ -	$ 4,603.51
David Thrasher, Office Assistant	$ 8,576.99	$ -	$ 8,576.99
Luther Quintanna, Serviceman	$ 944.16	$ -	$ 944.16
	$ 17,294.16	$ -	$ 17,294.16
Total	$ 51,880.69	**$ (8,900.51)**	**$ 42,980.18**

	Officer Salary (Mark Grapp)		
	Per CSB 3-12 C		
	Amount Before Allocation	4-Factor Allocation Percentage	Allocated Amount
Cedar Grove	$ 66,775.94	0.543618827	$ 36,300.66
Watco	**$ 66,775.94**	**0.384659767**	**$ 25,686.02**
Serviceberry	$ 66,775.94	0.040500058	$ 2,704.43
A. Petersen	$ 66,775.94	0.031221349	$ 2,084.83
		1.000000000	$ 66,775.94

STAFF ADJUSTMENTS (Cont.)

B -	OFFICE SUPPLIES AND EXPENSES	$	6,769	
	Per Staff		5,500	($1,269)

To reflect Staff's calculation of the allocated portion of the office supplies and expenses using Staff's four-factor allocation methodology.

Calculation of Office Supplies Exp

Allocated Shared Expenses	**$**	**2,446.48**
Total Non-Allocable Direct Expenses	**$**	**3,053.91**
Total Office Supplies and Expenses	**$**	**5,500.39**

Office Supplies and Expenses Per CSB 3-6	Amount Before Allocation	4-Factor Allocation Percentage	Allocated Amount
Cedar Grove	$ 6,360.12	0.543618827	$ 3,457.48
Watco	**$ 6,360.12**	0.384659767	**$ 2,446.48**
Serviceberry	$ 6,360.12	0.040500058	$ 257.59
A. Petersen	$ 6,360.12	0.031221349	$ 198.57
		1.0000000000	$ 6,360.12

Office Supplies and Expenses	Amount Before Allocation
APS - Electric	$ 1,111.28
City of Show Low - Water & Swr	$ 225.66
UNS Gas	$ 36.75
TAK Technology - Comp Software	$ 965.82
Amer Business - Stmnt Forms	$ 386.50
Baker Office Supply - File Cabinet	$ 179.89
White Mtn Publishing-Legal Notice	$ 52.40
Rim Communications - Pager	$ 176.67
Frontier Communications - Teleph	$ 1,571.73
Cellular One	$ 1,653.42
Total Allocable Expenses	**$ 6,360.12**

Non-Allocable (Direct) Expenses	
United States Postal Service	$ 1,891.75
Bank of Amer - Service Charges	$ 395.29
Arizona Blue Stake	$ 11.92
Walmart - Office Supplies	$ 217.28
GBS - November 27 Payment	$ 150.00
GBS - Inv. #2422 & 2342	$ 327.67
Luther Quintana - Exp Reimb	$ 50.00
City of Show Low - Acct/License#	$ 10.00
Total Direct Expenses for Watco	**$ 3,053.91**

STAFF ADJUSTMENTS (Cont.)

C -	OUTSIDE SERVICES - Per Company	$2,694	
	Per Staff	1,326	($1,368)

To reflect Staff's calculation of the allocated portion of the outside services using Staff's four-factor allocation methodology.

Outside Services					
		Amount Before Allocation	Allocation Percentage		Allocated Amount
Cedar Grove	$	3,447.62	0.543618827	$	1,874.19
Watco	**$**	**3,447.62**	**0.384659767**	**$**	**1,326.16**
Serviceberry	$	3,447.62	0.040500058	$	139.63
A. Petersen	$	3,447.62	0.031221349	$	107.64
			1.000000000	$	3,447.62

	Outside Services					
	Amount Before Allocation					
		Per Company Invoices		Staff Adj		Per Staff
Best Accounting Solutions, Quick Books Pro 2005	$	222.62	$	-	$	222.62
Best Accounting Solutions, Monthly Accounting Agreement	$	300.00	$	-	$	300.00
Best Accounting Solutions, Monthly Accounting, Fed & State Tax Prep	$	700.00	$	-	$	700.00
Best Accounting Solutions; Monthly Accounting Agreement, Quick Books Training	$	325.00	$	-	$	325.00
st Accounting Solutions; Monthly Accounting Agreement, Quick Books troubleshooting	$	325.00	$	-	$	325.00
JNJ Accounting & Tax Service, State & Fed Tax Prep (Personal Taxes)	$	470.00	$	(470.00)	$	-
JNJ Accounting & Tax Service, Bookkeeping for Nov 2005	$	375.00	$	-	$	375.00
JNJ Accounting & Tax Service, Tax Preparation for 2004	$	300.00	$	(300.00)	$	-
JNJ Accounting & Tax Service, Organize Jan - Aug 2005	$	1,200.00	$	-	$	1,200.00
Ken Issacson Billings, Engineering Billings	$	200.00	$	(200.00)	$	-
Ken Issacson Billings, Engineering Billings	$	200.00	$	(200.00)	$	-
Ken Issacson Billings, Engineering Billings	$	222.50	$	(222.50)	$	-
Ken Issacson Billings, Engineering Billings	$	222.50	$	(222.50)	$	-
Total Outside Services Expense To Be Allocated	$	5,062.62	$	(1,615.00)	**$**	**3,447.62**

D -	WATER TESTING - Per Company	$	222	
	Per Staff		1,821	$1,599

To reflect Staff's annual water testing expense

STAFF ADJUSTMENTS (Cont.)

E -	RENTS EXPENSE - Per Company	$	5,901	
	Per Staff		3,159	($2,742)

To reflect Staff's calculation of the allocated portion of the rents using Staff's four-factor allocation methodology.

Rents Per CSB 2-3 A					
		Amount Before Allocation	Allocation Percentage		Allocated Amount
Cedar Grove	$	8,211.72	0.543618827	$	4,464.05
Watco	**$**	**8,211.72**	0.384659767	**$**	**3,158.72**
Serviceberry	$	8,211.72	0.040500058	$	332.58
A. Petersen	$	8,211.72	0.031221349	$	256.38
			1.000000	$	8,211.72

Note: The Company reported monthly rent expense amount was $684.31 ($684.31 x 12 months = $8,211.72).

F -	TRANSPORTATION EXPENSE - Per Company	$	6,457	
	Per Staff		4,536	($1,921)

To reflect Staff's calculation of the transportation expense.

Annual number of miles driven per last Staff report		9,675.00
2006 IRS standard mileage rate	$	0.445
	$	4,305.38
Plus: Allocated transportation expense	**$**	**230.80**
Total transportation expense	**$**	**4,536.17**

Transportation Expense Per CSB 2-3 B and CSB 3-10					
		Amount Before Allocation*	Allocation Percentage		Allocated Amount
Cedar Grove	$	600.00	0.543618827	$	326.17
Watco	**$**	**600.00**	0.384659767	**$**	**230.80**
Serviceberry	$	600.00	0.040500058	$	24.30
A. Petersen	$	600.00	0.031221349	$	18.73
			1.000000	$	600.00

***Note:** The Company reported annual transportation amount was $7,200. Staff removed $6,600 in vehicle loan payments ($7,200 - $6,600 = $600). Watco, Inc. does not own the vehicle used in operations.

STAFF ADJUSTMENTS (Cont.)

G -	GENERAL LIABILITY INSURANCE - Per Company	$	2,825	
	Per Staff		1,222	($1,603)

To reflect Staff's calculation of the general liability insurance cost using Staff's four-factor allocation methodology (See Note below).

Insurance, General Liability						
Per CSB 3-5						
		Amount Before Allocation*	Allocation Percentage		Allocated Amount
Cedar Grove	$	3,176.00	0.543618827	$	1,726.53
Watco	**$**	**3,176.00**	**0.384659767**	**$**	**1,221.68**
Serviceberry	$	3,176.00	0.040500058	$	128.63
A. Petersen	$	3,176.00	0.031221349	$	99.16
			1.000000	$	3,176.00

***Note:** The Company provided a 2006 insurance policy to support the 2005 expense. The annual amount was $3,979 for five companies: Watco, Inc., Cedar Grove Water,Inc., Cedar Grove Water Management Company, Serviceberry, and A Peterson Water Co., Inc. Because Cedar Grove Water Management Company is unregulated, Staff removed one-fifth of the insurance cost and allocated the remaining four-fifths among the regulataed utilities ($3,970 / 5 = $794; $3,970 - $794 = **$3,176**)

STAFF ADJUSTMENTS (Cont.)

H -	DEPRECIATION - Per Company	$17,174	
	Per Staff	15,790	($1,384)

Acct No.	DESCRIPTION	[A] PLANT In SERVICE Per Staff	[B] NonDepreciable or Fully Depreciated PLANT	[C] DEPRECIABLE PLANT (Col A - Col B)	[D] DEPRECIATION RATE	[E] DEPRECIATION EXPENSE (Col C x Col D)
301	Organization	$ 1,542	$ 1,542	$ -	0.00%	$ -
302	Franchises	$ 7	$ 7	$ -	0.00%	$ -
303	Land & Land Rights	$ 27,094	$ 27,094	$ -	0.00%	$ -
304	Structures & Improvements	$ 5,135	$ -	$ 5,135	3.33%	$ 171
307	Wells & Springs	$ 19,361	$ -	$ 19,361	3.33%	$ 645
311	Pumping Equipment	$ 12,623	$ -	$ 12,623	12.50%	$ 1,578
320	Water Treatment Equipment	$ -	$ -	$ -	0.00%	$ -
330.1	Distribution Reservoirs - Storage	$ 18,265	$ -	$ 18,265	2.22%	$ 405
330.2	Distribution Reservoirs - Pressure	$ 25,078	$ -	$ 25,078	5.00%	$ 1,254
331	Transmission & Distribution Mains	$ 380,944	$ -	$ 380,944	2.00%	$ 7,619
333	Services	$ 66,048	$ -	$ 66,048	3.33%	$ 2,199
334	Meters & Meter Installations	$ 23,039	$ -	$ 23,039	8.33%	$ 1,919
335	Hydrants	$ -	$ -	$ -	0.00%	$ -
336	Backflow Prevention Devices	$ -	$ -	$ -	0.00%	$ -
339	Other Plant and Misc. Equipment	$ -	$ -	$ -	0.00%	$ -
340	Office Furniture & Equipment	$ -	$ -	$ -	0.00%	$ -
341	Transportation Equipment	$ -	$ -	$ -	0.00%	$ -
343	Tools Shop & Garage Equipment	$ -	$ -	$ -	0.00%	$ -
	Total Plant	$ 579,136	$ 28,643	$ 550,493		$ 15,790

Depreciation Expense Before Amortization of CIAC:	$	15,790
Less Amortization of CIAC*:	$	-
Test Year Depreciation Expense - Staff:	**$**	**15,790**
Depreciation Expense - Company:	$	17,174
Staff's Total Adjustment:	**$**	**(1,384)**

*** Amortization of CIAC Calculation:**		
Contribution(s) in Aid of Construction (Gross)	$	-
Less: Non Amortizable Contribution(s)		0
Less: Fully Amortized Contribution(s)		0
Amortizable Contribution(s)	$	-
Times: Staff Proposed Amortization Rate		0.00%
Amortization of CIAC	$	-

STAFF ADJUSTMENTS (Cont.)

I	-	TAXES OTHER THAN INCOME - Per Company	$	4,564	
		Per Staff		0	($4,564)
		To reflect removal of sales taxes included in operating expense.			
J	-	INTEREST EXPENSE ON LONG-TERM DEBT - Per Company	$	157	
		Per Staff		37,358	$37,201
		To reflect interest expense on Staff's recommended L.T. Debt			

Watco, Inc.
W-20475A-06-0550
Test Year Ended 12/31/05

	Calculation of Four-Factor Allocation					
	[A]	[B]	[C]	[D]	[E]	[A]
	Direct Labor Hours	Direct Oper Expenses	Number of Customers	Net Plant	Total (Col A+B+C+D)	Allocation % (Col E / 4)
Cedar Grove	0.57397574	0.46814485	0.410169492	0.722185225	2.174475306	0.543618827
Watco	**0.41508143**	**0.42875766**	**0.484745763**	**0.210054209**	**1.538639066**	**0.384659767**
Serviceberry	0.00364761	0.05850152	0.037288136	0.062562967	0.162000233	0.040500058
A. Petersen	0.00729522	0.04459597	0.06779661	0.005197599	0.124885395	0.031221349
	1.00000000	1.00000000	1.00000000	1.00000000	4.00000000	1.00000000

Direct Labor Hours Worked for Each Company by Employee From Data Request CSB 3-4					
Employee Name	Cedar Grove	**Watco**	Serviceberry	A. Petersen	Total
Thomas Grapp	460.00	**44.50**	1.00	6.50	512.00
Lori Baker	34.25	**34.25**	-	-	68.50
Ty Harmon	321.00	**88.00**	11.00	7.00	427.00
Barbie Grapp	31.76	**31.76**	-	-	63.51
Mark Grapp II	27.25	**32.25**	-	-	59.50
Richard Grapp	-	**30.00**	-	-	30.00
Jeffrey Felsted	79.50	**2.50**	-	-	82.00
Lyndee Grapp	493.00	**492.75**	-	-	985.75
David Thrasher	1,055.88	**1,055.62**	-	-	2,111.50
Luther Quintana	93.75	**66.00**	4.50	19.50	183.75
	2,596.39	**1,877.63**	16.50	33.00	4,523.51
Direct Labor Hrs. Allocation %:	0.57397574	**0.41508143**	0.00364761	0.00729522	1.00

Number of Customers by Company From Data Request CSB 2-3 D					
	Cedar Grove	**Watco**	Serviceberry	A. Petersen	Total
No. of Customers	242.00	**286.00**	22.00	40.00	590.00
No. of Customers Allocation %:	0.410169492	**0.48474576**	0.037288136	0.06779661	1.00

Net Plant by Company Source: CG, rate app (per Co); Watco, rate app (Staff adj); SB, 2005 ann reprt; AP, rate app (Staff adj)					
	Cedar Grove	**Watco**	Serviceberry	A. Petersen	Total
Net Plant	549,809.00	**159,917.00**	47,630.00	3,957.00	761,313.00
Net Plant Allocation %:	0.722185225	**0.21005421**	0.062562967	0.005197599	1.00

Direct Operating Expenses (Excluding Salaries & Wages) Source: CG, rate app (per Co); Watco, rate app (per Co); SB, 2005 ann reprt; AP, rate app (Staff adj)					
	Cedar Grove	**Watco**	Serviceberry	A. Petersen	Total
Purchased Pwr	$ 12,274.00	**$ 8,140**	$ 771.00	$ 1,753.00	$ 22,938.00
Repairs & Maintenace	$ 4,787.00	**$ 2,011.00**	$ 63.00	*$ 79.00*	$ 6,940.00
Outside Services	$ 3,067.00	**$ 1,326.16**	$ 183.00	$ 492.00	$ 5,068.16
Water Testing	$ 378.00	**$ 1,821.00**	$ 201.00	$ 625.00	$ 3,025.00
Depreciation Expense	$ 13,753.00	**$ 15,790.40**	$ 2,833.00	$ 16.00	$ 32,392.40
Property Taxes	$ 1,023.00	**$ 3,225.00**	$ 358.00	$ 396.00	$ 5,002.00
	$ 35,282.00	**$ 32,313.56**	$ 4,409.00	$ 3,361.00	$ 75,365.56
Direct Oper Exp Allocation %:	0.46814485	**0.42875766**	0.05850152	0.044595965	1.00

Watco, Inc.
Docket No. W-20475A-06-0550
Test Year Ended December 31, 2005

Schedule CSB-4

RATE DESIGN

	Present	-Proposed Rates-	
Monthly Customer Charge:	Rates	Company	Staff
5/8" x 3/4" Meter	$14.55	$27.50	**$22.00**
3/4" Meter	22.00	41.25	**33.26**
1" Meter	40.00	68.75	**60.48**
1½" Meter	74.00	137.50	**111.89**
2" Meter	118.00	220.00	**128.00**
3" Meter	221.00	412.50	**330.00**
4" Meter	369.00	687.50	**550.00**
6" Meter	738.00	1,375.00	**1,100.00**
Gallons Included In Monthly Customer Charge:			
For all meter sizes	0	0	0
Commodity Rates:			
Per 1,000 Gallons for 0 to 3,000 Gallons	N/A	N/A	**$3.00**
Per 1,000 Gallons for 3,001 to 10,000 Gallons	N/A	N/A	**$4.00**
Per 1,000 Gallons for Gallons in Excess of 10,000	N/A	N/A	**$5.00**
Per 1,000 Gallons for 0 to 4,000 Gallons	$2.25	$3.75	**N/A**
Per 1,000 Gallons for 4,001 to 20,000	$2.50	$4.00	**N/A**
Per 1,000 Gallons for Gallons in Excess of 20,000	$3.00	$4.50	**N/A**
Bulk Water Rate per 1,000 Gallons	N/A	$6.50	**$5.00**

	Present	Company	Staff Proposed		
Service Line and Meter Installation Charges	Rates	Proposed	Services	Meters	Total
5/8" x 3/4" Meter	$290.00	$290.00	**$0.00**	**$0.00**	**$0.00**
3/4" Meter	320.00	320.00	**220.00**	**100.00**	**$320.00**
1" Meter	370.00	370.00	**245.00**	**125.00**	**$370.00**
1 1/2" Meter	545.00	545.00	**275.00**	**270.00**	**$545.00**
2" Meter	750.00	750.00	**300.00**	**450.00**	**$750.00**
3" Meter	980.00	980.00	**340.00**	**640.00**	**$980.00**
4" Meter	1,820.00	1,820.00	**600.00**	**1,220.00**	**$1,820.00**
6" Meter	3,920.00	3,920.00	**1,060.00**	**2,860.00**	**$3,920.00**

Service Charges			
Establishment	$25.00	$25.00	**$25.00**
Establishment (After Hours)	40.00	40.00	**40.00**
Reconnection (Delinquent)	25.00	25.00	**25.00**
Reconnection (Delinquent - After Hours)	N/A	60.00	**37.50**
Meter Test (If Correct)	35.00	50.00	**35.00**
Deposit	*	45.00	**45.00**
Deposit Interest	*	*	*
Re-Establishment (Within 12 Months)	**	**	**
NSF Check	20.00	30.00	**20.00**
Deferred Payment	1.50%	18.00%	**1.50%**
Meter Re-Read (If Correct)	20.00	25.00	**20.00**
Late Fee	1.50%	18.00%	**1.50%**
Fire Sprinkler System	***	***	***

* Per Commission Rules (R14-2-403.B)
** Months off system times the minimum (R14-2-403.D)
*** 1% of monthly minimum for a comparable sized meter connection, but no less than $5.00 per month. The service charge for fire sprinklers is only applicable for service lines separate and distinct from the primary water service line.
N/A: Not applicable

Watco Inc.
Docket No. W-20475A-06-0550 | Schedule 5
Test Year Ended December 31, 2005

TYPICAL BILL ANALYSIS
General Service 5/8 X 3/4 - Inch Meter

Average Number of Customers: 289

Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	4,938	$25.90	$46.25	$20.35	78.6%
Median Usage	3,317	$22.01	$39.94	$17.93	81.5%
Staff Proposed					
Average Usage	4,938	$25.90	$38.75	$12.85	49.6%
Median Usage	3,317	$22.01	$32.27	$10.26	46.6%

Present & Proposed Rates (Without Taxes)
General Service 5/8 X 3/4 - Inch Meter

Gallons Consumption	Present Rates	Company Proposed Rates	% Increase	Staff Proposed Rates	% Increase
0	$14.55	$27.50	89.0%	$22.00	51.2%
1,000	16.80	31.25	86.0%	25.00	48.8%
2,000	19.05	35.00	83.7%	28.00	47.0%
3,000	21.30	38.75	81.9%	31.00	45.5%
4,000	23.55	42.50	80.5%	35.00	48.6%
5,000	26.05	46.50	78.5%	39.00	49.7%
6,000	28.55	50.50	76.9%	43.00	50.6%
7,000	31.05	54.50	75.5%	47.00	51.4%
8,000	33.55	58.50	74.4%	51.00	52.0%
9,000	36.05	62.50	73.4%	55.00	52.6%
10,000	38.55	66.50	72.5%	59.00	53.0%
15,000	51.05	86.50	69.4%	84.00	64.5%
20,000	63.55	106.50	67.6%	109.00	71.5%
25,000	78.55	129.00	64.2%	134.00	70.6%
50,000	153.55	241.50	57.3%	259.00	68.7%
75,000	228.55	354.00	54.9%	384.00	68.0%
100,000	303.55	466.50	53.7%	509.00	67.7%
125,000	378.55	579.00	53.0%	634.00	67.5%
150,000	453.55	691.50	52.5%	759.00	67.3%
175,000	528.55	804.00	52.1%	884.00	67.3%
200,000	603.55	916.50	51.9%	1,009.00	67.2%

Engineering Report
For
WATCO, Inc. ("Company")

Docket No. W-20475A-06-0357 (Financing)
Docket No. W-20475A-06-0550 (Rates)

By: Katrin Stukov
Utilities Engineer

August 28, 2007

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CONCLUSIONS

1. The Silver Lake water system has water loss of 14.5% and the Bourdon Ranch water system has a water loss of 4.8%. If systems are considered as interconnected, the combined system would have a water loss of 13.5%.

2. The Silver Lake water system has adequate storage, but lacks adequate well capacity to serve the present customer base, and the Bourdon Ranch water system has adequate well and storage capacities to serve the present customer base and reasonable growth. If these two systems are interconnected, the combined system's production and storage capacity could adequately serve the existing customer base and reasonable level of growth.

3. Both the Company's water systems have arsenic concentration of less than 10 parts per billion and are currently meeting the new arsenic standard.

4. The Arizona Department of Environmental Quality ("ADEQ") has determined that both water systems are currently in full compliance with ADEQ requirements and delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

5. The Company is not located in an Active Management Area and therefore is not subject to Arizona Department of Water Resources ("ADWR") reporting and conservation requirements.

6. A check with the Utilities Division Compliance Section showed that there is one delinquency for the Company. As part of Decision No. 69391 the Commission ordered the following: That Watco file, by August 1, 2007, with the Commission's Docket Control, as a compliance in this docket, a copy of the ADEQ Approval to Construct ("ATC") or a letter that an ATC is not required from ADEQ for the interconnection of the Silver Lake and Bourdon Ranch systems.

7. The Company has a curtailment plan tariff that became effective on November 20, 2002, per Decision No.65416.

8. The Company has an approved backflow prevention tariff that became effective on January 27, 2003, per Decision No.65549.

9. A Financing Application for the proposed Phase 1 improvements and estimated costs appear to be reasonable and appropriate. However, approval of this Financing Application does not imply any particular future treatment for rate. No "used and useful" determination of the proposed plant was made, and no conclusions should be inferred for rate making or rate base purposes.

RECOMMENDATIONS

1. The Silver Lake water system has water loss of 14.5%. Staff recommends that the Company continue to monitor its system and, in compliance with Decision No.66175 dated August 13, 2003, annually report to the ACC the number of meters replaced and the water loss data including quantity of water pumped, gallons sold and water loss percentage for each month. The Company shall file its first report with Docket Control, as a compliance item in this docket, within six month of the effective date of the decision in this case. The Company shall reduce its water loss to 10% or less by December 31, 2009.

2. Staff recommends that any decision granting the new rates and charges in this proceeding should not become effective until the Company file with Docket Control, as a compliance item in this docket, a copy of the ADEQ Approval to Construct ("ATC") or a letter that an ATC is not required from ADEQ for the interconnection of the Silver Lake and Bourdon Ranch systems, as ordered in Decision No. 69391 dated March 22, 2007.

3. Staff recommends that in compliance with Decision No.69391 dated March 22, 2007, the Company file, by June 1, 2008, with Docket Control, as a compliance item in this docket, a copy of the ADEQ Approval of Construction ("AOC") for the interconnection of the Silver Lake and Bourdon Ranch systems.

4. Staff recommends its estimated annual water testing expense of $1,821 be used for purposes of setting rates in this proceeding.

5. Staff recommends that the Company continue using depreciation rates by individual NARUC category as delineated in Exhibit 3.

6. The Company has proposed to reduce its 5/8 X 3/4 meter and service line installation charge to $0.00. All other charges would remain the same. Staff separated service line and meter installation charges and recommends that charges listed in the right-hand column in Table 'C' be adopted (See Section K – Service Line and Meter Installation Charges for further discussion).

7. Staff recommends Commission approval of the Financing Application for Phase 1 improvements be conditional on the Company filing with Docket Control, as a compliance item in this docket, a copy of the ADEQ ATC for the proposed storage tank by June 1, 2008.

A. INTRODUCTION AND LOCATION OF COMPANY

On August 31, 2006 WATCO, Inc. ("WATCO" or "Company") filed a rate application with the Arizona Corporation Commission ("ACC" or "Commission"). WATCO consists of two separate water systems: Silver Lake and Bourdon Ranch. The Company's CC&N covers an area roughly 3.1 square miles in size and is located about 6 miles northeast of Show Low. The Silver Lake system serves approximately 258 customers in section 35, and the Bourdon Ranch system serves approximately 29 customers in section 25. The water systems are not currently interconnected. Exhibit 1 describes the certificated area of the water company within Navajo County.

B. DESCRIPTION OF THE WATER SYSTEMS

The plant facilities were visited on December 7, 2006, by Katrin Stukov in the accompaniment of Thomas Grapp, the Company's representative.

The two systems follow typical configurations found in small water systems. Each system consists of a well, which pumps into a storage tank, followed by booster pumps and a pressure tank. Exhibit 2 provides a process schematic for the water system.

Table 'A' below shows the plant facilities summary (as reported by the Company).

Table A. Well Data &Plant Summary

		Silver Lake	**Bourdon Ranch**
ADWR ID No.		55-603156	55-506606
Casing Size		8 inch	6 inch
Casing Depth		538 ft	440 feet
Pump Type		Submersible	Submersible
Pump Size		10 Hp	5 Hp,
Pump Yield		58 gallon per minute (GPM)	31 GPM
Storage		100,000 gallons	25,000 gallons
Booster Pumps		Four 2 HP, two in series	Two 2 HP
Pressure Tanks		One 10,000 gallons	One 3,000 gallons
Fire Hydrants (standard)		One	N/A
Structures		23'x 20' building	12'x 30' building
Other		Fencing	N/A
		Distribution Mains	
Size (in inches)	Material	Length (in feet)	Length (in feet)
4	AC/PVC	33,872	-
6	PVC	4,286	4,480
		Meters	
Size (in inches)		5/8 x 3/4	5/8 x 3/4
Quantity		258	29

C. ARSENIC

The U.S. Environmental Protection Agency has reduced the arsenic maximum contaminant level ("MCL") in drinking water from 50 parts per billion ("ppb") to 10 ppb.

The Company reported arsenic concentrations less than 1 ppb for the Silver Lake well and 2 ppb for the Bourdon Ranch well. Based on this data, both water systems are in compliance with the new arsenic MCL.

D. ADEQ COMPLIANCE

The ADEQ has determined that both water systems (the Bourdon Ranch Estates PWS # 09-027 & the Silver Lake PWS # 09-049) are in full compliance with ADEQ requirements and delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

E. ACC COMPLIANCE

A check with the Utilities Division Compliance Section showed that there is one delinquency for the Company[1]. As part of Decision No. 69391 the Commission ordered the following: that Watco file, by August 1, 2007, with the Commission's Docket Control, as a compliance in this docket, a copy of the ADEQ Approval to Construct ("ATC") or a letter that an ATC is not required from ADEQ for the interconnection of the Silver Lake and Bourdon Ranch systems.

On August 28, 2007 the Company has informed Staff that its Engineer is preparing a filing with ADEQ to obtain the ATC it needs to comply with Decision No. 69391. Staff believes that the Company should have taken action sooner to obtain the ATC from ADEQ.

F. ADWR COMPLIANCE

The Company is not within an Active Management Area, and consequently is not subject to ADWR reporting and conservation requirements.

G. WATER TESTING EXPENSE

The Company is subject to mandatory participation in the Monitoring Assistance Program ("MAP"). Participation in the MAP program is mandatory for water systems, which serve less than 10,000 persons (approximately 3,300 service connections).

For the Test Year ended December 31, 2005, the Company reported its water testing expense at $302 for both systems (excluding $1,223 in MAP fees). Staff has estimated testing expense at $1,821 total for both systems including $1,223 in MAP fees ($1,222 for the Silver Lake system and $599 for the Bourbon Ranch system).

[1] Per ACC Compliance status check dated August 28, 2007.

Table 'B' below shows Staff's annual monitoring expense estimate for each system with participation in the MAP.

Table B. Water Testing Cost

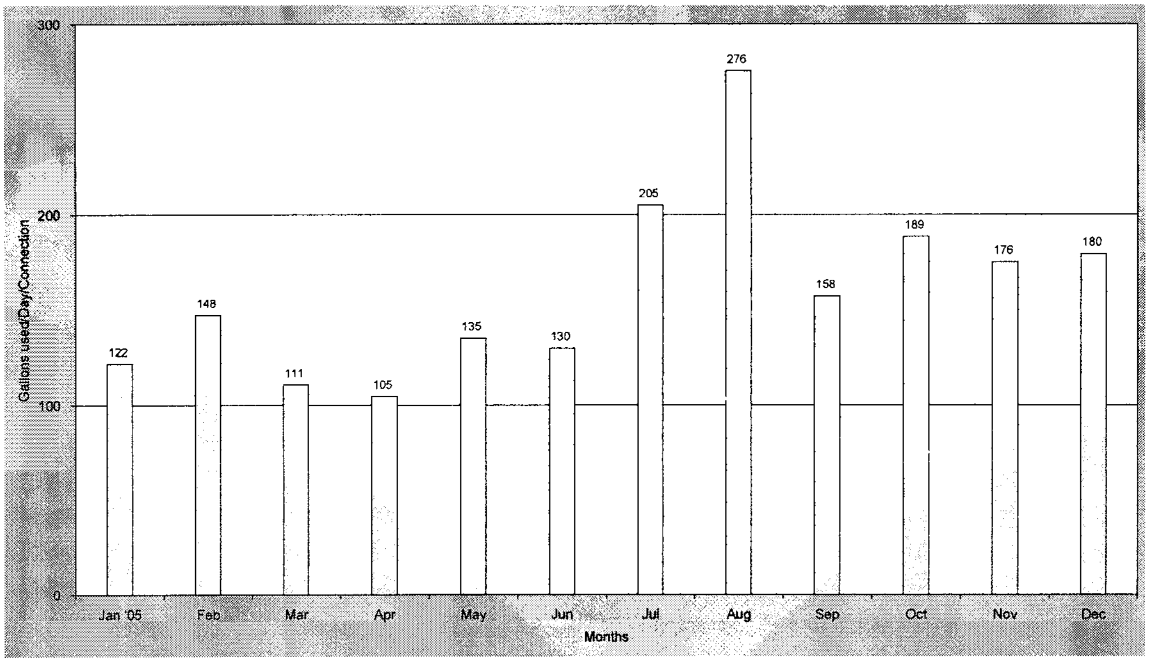
Monitoring	Cost per test	No. of tests per year for each system	Silver Lake Annual Cost	Bourdon Ranch Annual Cost
Total coliform – monthly	$17	12	$204	$204
Inorganics – Priority Pollutants	MAP	MAP	MAP	MAP
Radiochemical – per 4 years	MAP	MAP	MAP	MAP
Phase II and V:				
Nitrate – annual	$20	1	$20	$20
Nitrite – once per period	MAP	MAP	MAP	MAP
Asbestos – per 9 years	MAP	MAP	MAP	MAP
MAP – IOCs, SOCs, & VOCs	MAP	MAP	*$898	*$325
Lead & Copper – per 3 years	$30	10/3- yrs & 5/3-yrs.	$100	$50
Total			**$1,222**	**$599**

*Note: ADEQ - MAP invoices for the 2006 Calendar Year are $898 & $325.

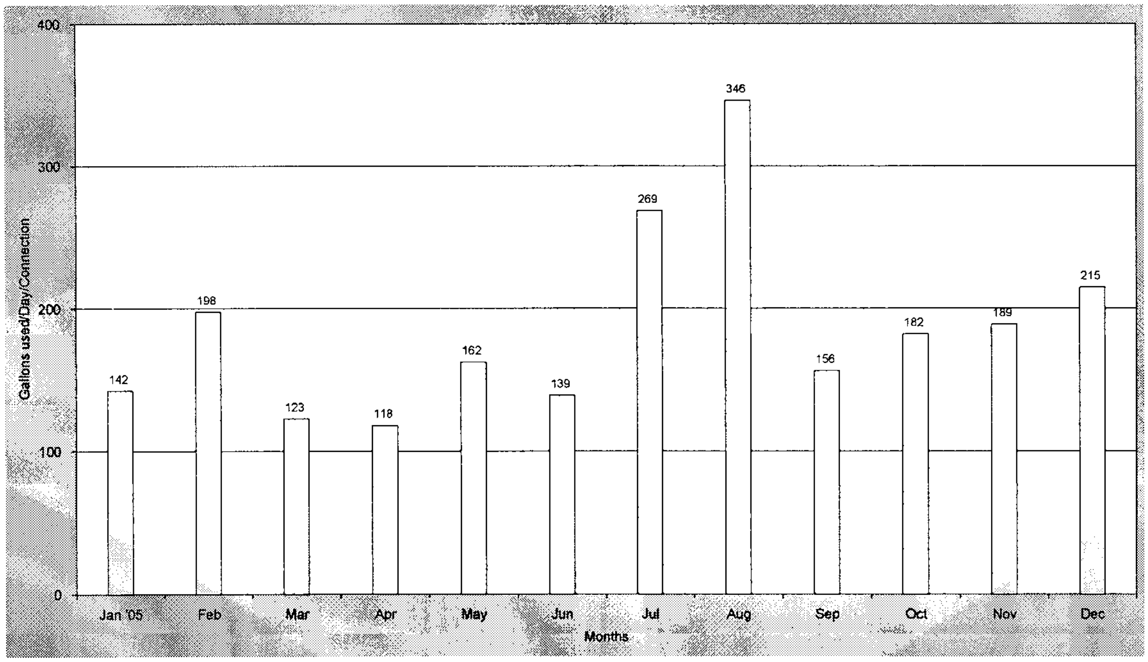
H. WATER USE

Water Sold

Based on the information provided by the Company, water use for the year 2005 is presented below. For Silver Lake, the high water use was 276 gallons per day ("GPD") per connection in August, and the low water use was 105 GPD per connection in April. The average annual use was 161 GPD per connection. For Bourdon Ranch, the high water use was 346 GPD per connection in August, and the low water use was 118 GPD per connection in April. The average annual use was 187 GPD per connection.



Silver Lake Water Use



Bourdon Ranch Water Use

Non-account Water

Non-account water should be 10% or less. It is important to be able to reconcile the difference between water sold and the water produced by the source. A water balance will allow a water company to identify water and revenue losses due to leakage, theft, and flushing. Non-account water for the Company was calculated to be 14.5% at Silver Lake and 4.8% at Bourdon Ranch during 2005. If systems are considered as interconnected, the combined system would have a water loss of 13.5%.

The Company believes that much of the water loss at the Silver Lake is attributable to aging water meters and approximately 60 feet of water line that contained three leaks. According to the Company, this water line was replaced in February of 2006. The Company plans continuation of an ongoing water meter replacement program.[2]

Staff recommends that the Company continue to monitor its system and, in compliance with Decision No.66175 dated August 13, 2003, annually report to the Commission the number of meters replaced and the annual water loss data including quantity of water pumped, gallons sold and water loss percentage for each month. The water loss reports shall continue until the water loss is less than 10%. The Company shall reduce its water loss to 10% or less by December 31, 2009.

Existing Systems Analysis

1. Bourdon Ranch System.

The system's current well capacity of 31 GPM and storage capacity of 25,000 gallons could adequately serve approximately 43 connections. Staff concludes that the existing system has adequate production and storage capacity to serve the existing 29 connections.

2. Silver Lakes System

The system's current well capacity of 58 GPM and storage capacity of 100,000 gallons could adequately serve approximately 242 connections. Staff concludes that this system has adequate storage but lacks adequate well production capacity to serve the existing 258 connections.

3. Proposed interconnection of the two systems[3].

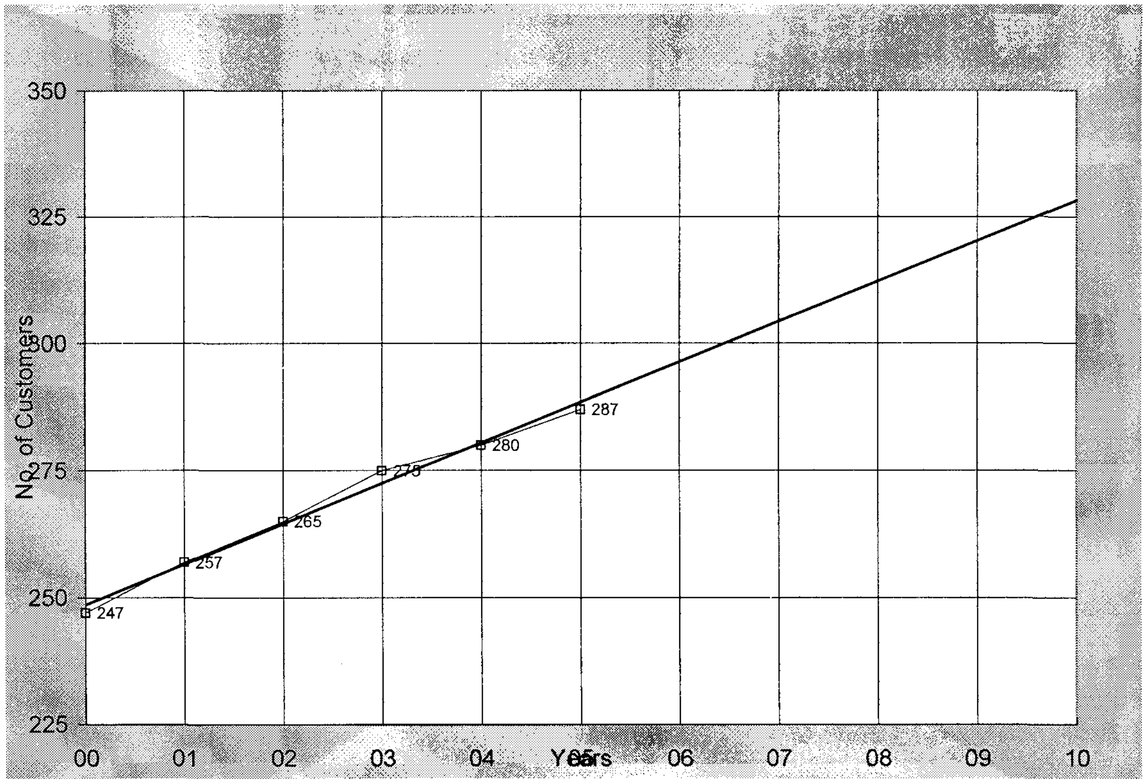
The Company is in process of obtaining a loan to finance the construction of the interconnection of the Silver Lake and Bourdon Ranch systems, in compliance with Decision No.68657 dated April 12, 2006. Staff concludes that if these two systems are interconnected, the combined system's production and storage capacity could adequately serve the existing customer base and a reasonable level of growth.

---

[2] See Section 'L' (Financing) in this report for more details.
[3] See Sections 'E' (ACC Compliance) and 'L' (Financing) in this report for more details.

I. GROWTH

Based on customer data obtained from the Company's Annual Reports, it is projected that the Company could have over 330 customers by 2010. The figure below depicts actual growth from 2000 to 2005 and projects an estimated growth for the next five years using linear regression analysis.



J. DEPRECIATION RATES

The Company has been using Staff's recommended depreciation rates per National Association of Regulatory Utility Commissioners ("NARUC") plant category. These rates are presented in Exhibit 3 and it is recommended that the Company continue using these depreciation rates by individual NARUC category.

K. OTHER ISSUES

1. Service Line and Meter Installation Charges

The Company has proposed to reduce its 5/8 x 3/4 meter and service line installation charge to $0.00. All other charges would remain the same. The Company has told Staff that it would prefer not to charge for the 5/8 meter because the administrative cost of refunding outweighs any benefit especially for the standard meter. The Company's existing charges for the larger size meters are substantially below what is typically charged but the Company believes the amounts will be sufficient to cover material costs and the Company will provide the labor. These charges are refundable advances. The Company would like to keep yearly refunds to a minimum which it believes will create less of a financial burden for it. Staff separated service line and meter charges and recommends that charges listed below in the right-hand column in Table 'C' be adopted.

Table C. Service Line and Meter Installation Charges

Meter Size	Company Current Charges	Company Proposed Charges	Staff's Recommendations		
			Service Line Charge	Meter Charge	Total Charge
5/8 x 3/4-inch	$290	$0	$0	$0	$0
3/4-inch	$320	$320	$220	$100	$320
1-inch	$370	$370	$245	$125	$370
1-1/2-inch	$545	$545	$275	$270	$545
2-inch	$750	$750	$300	$450	$750
3-inch	$980	$980	$340	$640	$980
4-inch	$1,820	$1,820	$600	$1,220	$1,820
6-inch	$3,920	$3,920	$1,060	$2,860	$3,920

2. Curtailment Plan Tariff

The Company has an approved curtailment tariff that became effective on November 20, 2002, per Decision No.65416.

3. Backflow Prevention Tariff

The Company has an approved backflow prevention tariff that became effective on January 27, 2003, per Decision No.65549.

L. FINANCING

On May 30, 2006, WATCO filed a financing application with ACC. As part of this financing application, the Company submitted a Design Report ("the Report") prepared by Mark Fleetwood, professional engineer. The Report outlined the proposed improvements which include the interconnection of the Silver Lake and Bourdon Ranch systems, the completion of a water meter replacement program, the replacement of an old 100,000 gallon storage tank which is in need of major repairs and the addition of fire protection capacities. The addition of fire protection will require installation of a larger storage tank (located on a high point near both subdivisions), a water line connecting the new tank to existing distribution system (a tie line), fire hydrants and upgrades to the existing distribution system. The Report, also, indicates that in the future, if the existing wells cannot produce required flows, another well will need to be drilled.

Sizing of the proposed storage tank

The ADEQ drinking water rules require at least one day's storage based on the average daily demand during the peak month of the year. The Company indicated that extra storage will provide sufficient time to respond should a major outage occur (such as, a well pump replacement, which has typically taken 2-3 days). The Company proposed to install a 500,000 gallon storage tank. This will provide sufficient storage capacity for a pump outage and fire flow capacity.

Phasing of construction

The Company is planning to construct the proposed improvements in the following two phases:

Phase 1 (proposed) will include permanent interconnection of the Silver Lake and Bourdon Ranch water systems, installation of a 500,000 gallons storage and tie line, and completion of a meter replacement program.

Phase 2 (future) will include an upgrade of water distribution lines and installation of fire hydrants to facilitate fire flow throughout the Company's service area.

Cost Associated with Phase 1

The Company's financing application is requesting approval for a Water Infrastructure Finance Authority ("WIFA") loan in the amount of $600,000. This WIFA loan will be supplemented with In-House funds to cover the estimated cost of the proposed Phase 1 improvements which will total $876,590. Staff concludes that the proposed Phase 1 improvements and estimated costs appear to be reasonable and appropriate. However, approval of this Financing Application does not imply any particular future treatment for rate base. No "used and useful" determination of the proposed plant was made, and no conclusions should be inferred for rate making or rate base purposes.

EXHIBIT 1

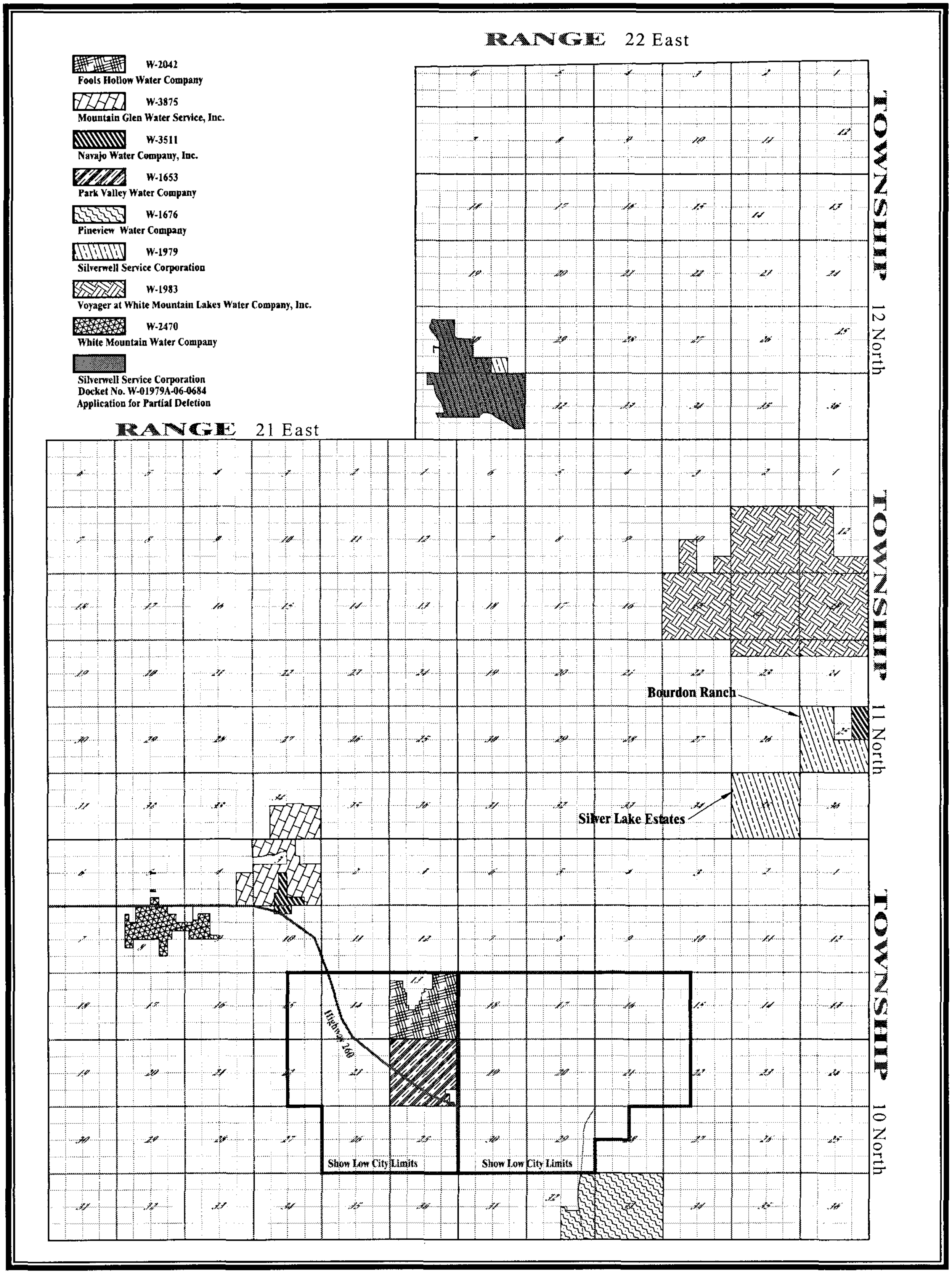
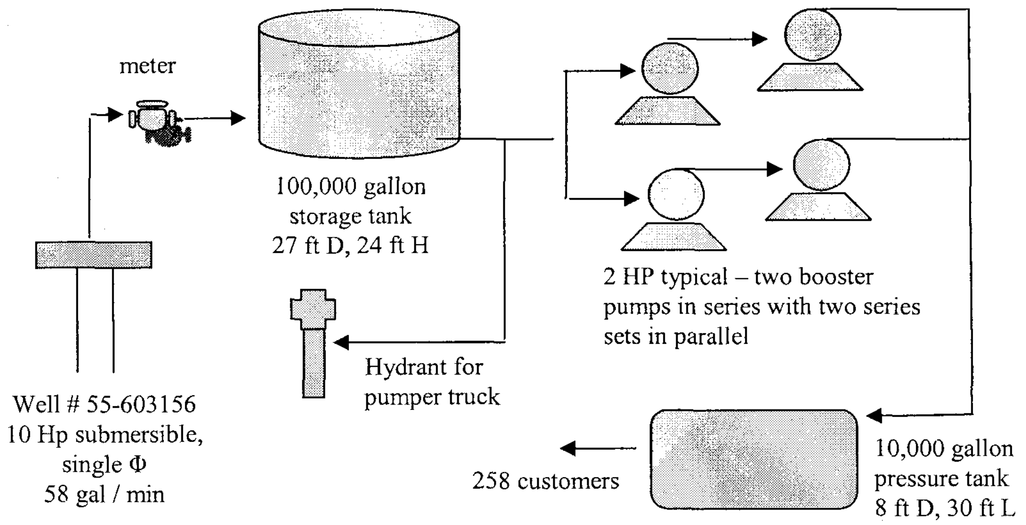
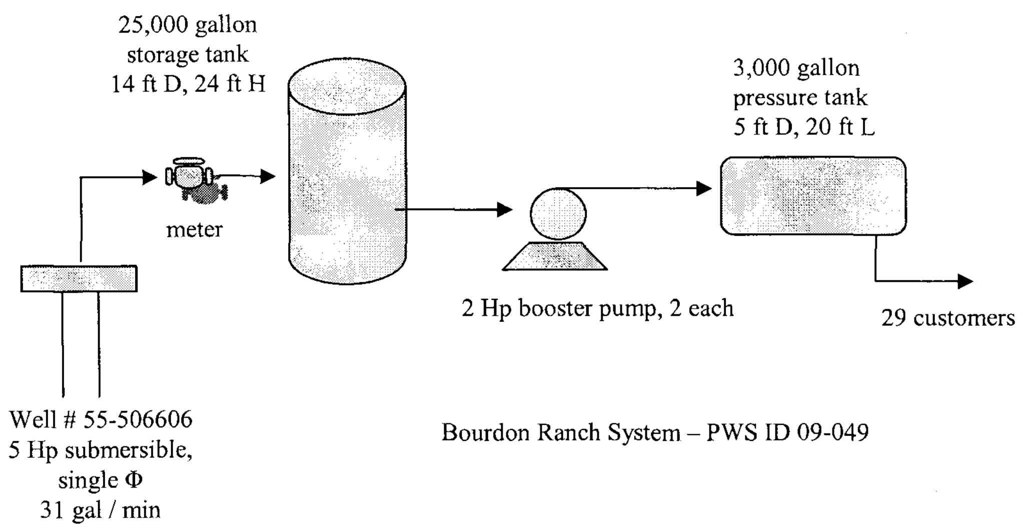

RANGE 22 East
RANGE 21 East
W-2042
Fools Hollow Water Company
W-3875
Mountain Glen Water Service, Inc.
W-3511
Navajo Water Company, Inc.
W-1653
Park Valley Water Company
W-1676
Pineview Water Company
W-1979
Silverwell Service Corporation
W-1983
Voyager at White Mountain Lakes Water Company, Inc.
W-2470
White Mountain Water Company
Silverwell Service Corporation
Docket No. W-01979A-06-0684
Application for Partial Deletion
TOWNSHIP 12 North
TOWNSHIP 11 North
TOWNSHIP 10 North
Bourdon Ranch
Silver Lake Estates
Highway 260
Show Low City Limits
Show Low City Limits

EXHIBIT 2

WATCO, Inc.
Process Schematics



Silver Lake Estates System – PWS ID 09-027



Bourdon Ranch System – PWS ID 09-049

EXHIBIT 3
TYPICAL DEPRECIATION RATES FOR WATER COMPANIES

NARUC Account No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.

2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.